

Harvard Business Review

Competitive Strategy

When Cutting Costs, Don't Lose Sight of Long-Term Organizational Health

by [Ron Carucci](#) and [Mindy Millward](#) February 07, 2023

Summary.

After three years of adapting to disrupted business conditions due to the pandemic, the aftermath of inflation and fears of recession have leaders scrambling to get budgets in line with slower revenue growth. Riddled with the anxiety of making the wrong choices and having to deliver tough news, leaders are often prone to making short-sighted decisions when cutting costs. And when it comes to sustaining the intended outcomes of cut costs, most organizations are abysmal. Rather than grasping at straws or doing what seems “least painful,” these are the turbulent times when leaders must double down on protecting the long-term aspirations and culture of their organization. If you're facing the need to tighten your belt, the authors present several ways to trim costs — without sacrificing the long-term health of the company.

As 2023 gets underway, fears of an economic turndown loom at many companies. The tech sector continues to announce layoffs, and many companies are battenning down the hatches in anticipation of challenging times. Some companies are putting the brakes on capital investments in 2023, while others are cutting into travel budgets, hiring and salary increases, and even some employee benefits.

After three years of adapting to disrupted business conditions due to the pandemic, the aftermath of inflation and fears of recession have leaders scrambling to get budgets in line with slower revenue growth. Riddled with the anxiety of making the wrong choices and having to deliver tough news, leaders are often prone to making short-sighted decisions when cutting costs. And when it comes to sustaining the intended outcomes of cut costs, most organizations are abysmal. According to one study, only 43% of companies actually achieve the cost reductions they reach for in the first year, and only 11% can sustain the prudent behaviors into year three. The ultimate failure comes from taking their eyes off the future. For example, only 9% of companies create enough capacity to take on growth and innovation to support their long-term aspirations.

Rather than grasping at straws or doing what seems “least painful,” leaders must double down on protecting the long-term aspirations and culture of their organization. If you're facing the need to tighten your belt, here are some important ways we've seen leaders trim costs — without sacrificing the long-term health of the company.

Stay focused on strategy, not cost goals.

Just because growth has not materialized, or external factors are contributing to reduced revenues and higher costs, doesn't mean your strategy isn't sound. Leaders

who jump into cost cutting without first reaffirming (and adjusting if necessary) the organization's strategy are likely to send their companies into whiplash. If your long-term strategy is still sound in contrast to current performance and results, it's time to lean into that strategy and figure out how to make short-term reductions that affirm long-term goals, rather than abandon them.

Leaders who effectively balance short-term reductions and longer-term aspirations find themselves asking questions such as, "Which of these costs are more wed to our past performance than future goals?" They lead the work of reducing expenses by making sure the organization has great clarity on their intended competitive advantage and the capabilities it will take to lead to success in the marketplace. Targets for cost cutting become part of strategy achievement, and in fact can escalate an organization's realization of its strategy if it's viewed as a continuous part of operating the company.

For example, one of our client's revenue recently dropped 25% in the span of 18 months. Faced with drastic cost cutting, they recommitted to a strategy that had them moving from predominantly one business sector (85% of their revenue) to a more distributed and balanced portfolio across three sectors longer-term. They hadn't made progress on the strategy because the managers of the legacy business were resistant to change, and the cost-cutting mandate provided a needed lever. As such, cost cutting focused specifically on their legacy segment, allowing them to achieve reductions of 20% in cost of goods sold, which supported simultaneous investment into the two fledgling sectors, escalating achievement of their goals. Used strategically, a downturn and its negative effects on the bottom line can give leaders the mandate they need to move quickly and decisively to the strategy of the future as opposed to cutting their way back to yesterday.

Protect your competitive work to ensure the company emerges stronger.

Too many leaders naively try to make cost cutting "fair" and issue blanket reductions across the organization. This is anything but fair. It presumes that all work and its resulting costs are "equal." To truly understand the value of activities you're considering cutting, analyze your company's work against your strategy by dividing it into three categories.

First, *competitive* work, usually around 15 to 20% of all activities, comprises the most strategically important work. Investing \$1 in this work should yield a \$5 return. It's the work that directly delivers the value that distinguishes you from your competition.

Second, *enabling* work, which accounts for another 15 to 20% of activity, is the work that directly supports competitive work. For example, if you compete on customer service to differentiate, customer analytics might be your enabling work.

The remaining 60 to 70% of work is *necessary* work: It keeps you in compliance and keeps the lights on.

Competitive and enabling work should be organized for maximum effectiveness. This is where you invest disproportionately in talent and technology. Necessary work should be organized for maximum efficiency — done in parity with competitor companies for the lowest possible cost. It's in this last category where you should target your largest efforts to cut costs. When leaders mistakenly cut work from competitive and enabling categories, they unwittingly weaken the organization's ability to grow when things turn around.

Face difficult emotions before you start.

Making decisions to reduce resources is fraught with emotional hurdles. You already know people are fearful and suspicious of your approach. You're likely anxious about the resentment and lowered morale you'll face after the decisions, especially if cuts will involve layoffs. And on a deeper level, you may be feeling guilt for the hurt you'll inflict, for the mistakes you might make, and perhaps for not having done a better job curbing expenses. This confluence of emotions will undoubtedly taint your decision making if you let it. Face these emotions head on before you begin your expense-reduction work.

Consider finding a trusted peer who is also faced with making cuts and talking openly with them about what you're feeling. For some leaders, journaling about the emotions also helps them process them. Find a way to get some of this emotional energy out of your mind to minimize the risk of it making things worse.

Leaders who don't do this risk burdening the organization with their emotional baggage in two ways. First, they pass on their guilt by playing the victim, talking openly about the pain of the decisions. Countless viral videos of executives feigning tears and anguish have backfired as employees feel great resentment for the aloofness those leaders displayed previously. And second, leaders try to soften the blow with statements starting with, "At least we..." or "We ought to be grateful that..." If your goal is to preserve relationships with those who must live with your cuts, face your emotions — and theirs — head on. Humility, genuine empathy, and care are critical to how you communicate and implement your choices.

Protect your future culture.

You can't avoid some impact on your organization's culture after you've made difficult resource reductions. But you can minimize it. Trust will be ruptured to some degree as you deprioritize what was "mission critical" last year and constrain or eliminate privileges people have come to enjoy — especially if people must say goodbye to colleagues. Two of the biggest killers of long-term trust are a lack of transparency in the process and a failure to reduce work commensurate with resources. Both just add insult to injury.

You need to be as transparent as possible with how cuts will be made, what criteria are being used, who gets to be involved and why, and the timing of the decisions. The more mysterious the process is, the more people are left to make up narratives about its unfairness, randomness, and ineptness. And that hypervigilance will remain long after the decisions. Some organizations mistakenly believe that minimizing transparency minimizes risk of legal action or unwanted defections, but actually, the

opposite is true. The less people trust your process or motives, the more they will assume the worst and want revenge. But allowing people a reasonable line of sight into how and what you chose to cut helps them see the difficulties behind those choices, even if they don't like the outcome.

Next, you must cut work commensurate with resources. The ill-fated “we have to do more with less,” especially in a workplace climate characterized by all kinds of quitting, will irreparably damage your future culture. This is especially true if the cuts included headcount. Scrutinize every resource cut through the lens of what productivity or results will likely be impacted. If you find yourself rationalizing that you can maintain current levels of performance with less budget or fewer bodies, know that you are mortgaging the culture to protect unsustainable results.

Engage people in hard decisions.

When facing tough calls, your instinct may be to isolate or solve big problems with a small task force. Sometimes this is done in the name of “protecting” employees from the harsh reality that results are not what they need to be. Sometimes it's done from a place of ego as senior leaders may think “there is no one else who sees the whole of the business.” And still other times it's done because there is a belief that “that's why you're paid the big bucks.” While these rationalizations have some merit, they're ultimately misplaced beliefs that cause cost cutting to go awry.

There are several reasons you should engage the broader organization in the work of cost cutting. First, those closest to the work are the most qualified to make intelligent choices about where to cut. They've lived with the excess and waste and have probably been sending you warning signs long before you chose to deal with it. Second, those who understand the intricacies of the organization are more likely to be harder on the budget than you because they don't want to go through additional rounds of cutting.

Lastly, they're better equipped to, and more invested in, protecting the right jobs and finding opportunities for cost cutting than you are — they live the work every day. If you give them permission and the responsibility to make decisions that will make their lives better while managing the resources of the organization more effectively, they will take the initiative to think innovatively and for the future, rather than just about short-term gains. The act of being engaged in the difficult work of cost cutting increases employees' commitment to the tough decisions they'll have to live with.

Focus on key talent and avoid regrettable losses.

Cost cutting almost always equates to making tough choices about employees. Organizations often struggle with making cuts when it comes to actual people, especially during times of plenty and growth. But the need to downsize your business, its spend, and its headcount is not an excuse to suddenly manage poor performance you've long ignored. Getting rid of underperformers isn't cost cutting — it's delayed cowardice and solidifies deceit in your culture.

Rather than uselessly fixating on poor talent, your time is better spent on identifying and investing in top talent whose confidence might be shaken by these decisions.

Work to earn their trust and commitment to stay as part of the solution and future. Engineered loss of employees is always difficult. But if your cost-cutting efforts lead to highly “regrettable losses,” either because you selected the wrong people or your inability to act drives top talent to leave, the consequences will last far into the future.

Learn your lessons from irresponsible growth.

Finally, learn from the pain of making cuts. Many organizations, especially in the tech sector, now have egg on their faces for over-exploiting the growth opportunities of the last two years. Their irresponsibility has led to tens of thousands now out of jobs. Pay close attention to areas where you found bloat in budgets, excessive hiring that was underutilized, or investments that were just whims. Those decisions represent flawed assumptions about whether growth was sustainable, overconfidence (perhaps even arrogance), and likely self-interest on the part of those who lobbied heavily for resources they didn’t need. Have the humility to look good and hard at how you ended up needing to make cuts in the first place. Use those lessons to develop future leaders who can help you apply them, and not repeat the problem when things turn around.

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Cost reductions are always difficult. If you’re faced with having to make difficult trade-offs to align your budget with revenue, keep your eye squarely on the future you want to emerge into. That’s the only hope you’ll have of actually getting there.

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